In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 1023

THE EXCHANGE AND SAVINGS BANK OF BERLIN,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

1. Petitioner, a bank, went into receivership in 1932. In March 1932 the bank's depositors agreed to assign 50 percent of their deposits to the bank, receiving in return a lien on the bank's future earnings. By 1957 the balance due the depositors under this agreement totaled some $92,000. By the end of 1957 a special reserve account set up to meet the depositors' claims contained a little over $79,000 and the bank carried a surplus on its books of $65,000, all but $13,000 derived from earnings subsequent to March 1932. The bank had net earnings (before taxes) of more than $25,000 in 1957. In 1958 and 1959 the bank's situation continued to improve. Indeed, as the court below pointed out (R. 14a), the excess of surplus (current earnings after taxes, surplus and

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special reserve) over the amount needed to satisfy the old depositors plus income taxes was $95,818.97 in 1958 and $112,818.45 in 1959.

In 1957, petitioner asked permission of the State Banking Commissioner to make a payment of 5 percent of the unpaid balance of the old depositor claims. Permission was refused on the ground that it would jeopardize the bank's current depositors and reduce the prospects for eventual full repayment to the old depositors. Petitioner was allowed to make a payment of 10 percent in 1958, on the condition (which was met) that it improve its loan portfolio, and it was also allowed to make 10 percent payments in 1959 and 1960. In 1961 it fully repaid the remaining balance due the old depositors (Pet. App. 14a).

Under Section 7507(b) of the Internal Revenue Code of 1954, a bank is exempt from federal income tax if its depositors released part of their claims in return for a lien on the bank's future earnings and if the payment of tax would diminish the bank's assets "which are available for the payment of such depositor claims and which are necessary for the full payment thereof." The issue in this case is the permissibility of taxing petitioner for the years 1957–1959. Petitioner's position is that the assets represented by its special reserve account and its post-1932 surplus account were not "available" for payment of the old depositors' claims because the State Banking Commissioner would not allow payment at all in 1957, and allowed only small amounts to be repaid in 1958 and 1959. Payment of any federal income tax in those years, the bank maintains, would

therefore have reduced the amount available to be repaid the old depositors (Pet. 13–15). We contended below that the assets "available" for repayment of the old depositors' claims were not to be restricted to those assets which the bank was actually able to release under orders of the banking authorities, but should be construed to mean the value of the bank's assets actually on hand at year's end as revealed by the balance sheet, even if restricted by local bank officials for purposes of State law. The Court of Appeals for the Fourth Circuit agreed, and held that the intention of Section 7507(b) was to permit the statutory exemption to continue until the bank had on hand accumulated assets sufficient in value to pay off the old depositors, but was not meant to permit a bank to build up an additional "cushion" of tax-free working surplus necessary to satisfy the standards of local administrative authorities (Pet. 16a–17a).

2. Although the decision of the court below is in conflict with the decision of the Court of Appeals for the Sixth Circuit in *United States* v. *Bank of Peipsic Co.*, 272 F. 2d 341, we submit that review by this Court is not required. We know of only one bank in the United States that is still making payments to old depositors due to past insolvency.[1] The virtually uni-

[1] We undertook to ascertain the practical importance of the issue in this case through inquiry of the Federal Deposit Insurance Corporation, the Federal Reserve Board and the Comptroller of the Currency. Of the 14,291 banks in the United States, the F.D.I.C. insures 13,873, and examines the books of the 7,392 State Banks that do not belong to the Federal Reserve System. The Examination Division of the F.D.I.C. has indicated that on the basis of reports from F.D.I.C.'s 12 regional

versal adoption of federal deposit insurance has made the problem of this case largely academic. No similar cases are pending or in prospect. The issue accordingly lacks general importance.

In addition, the decision below is in accord with the settled principle that exemptions from the federal tax laws should be strictly construed against the taxpayer (*e.g., Helvering* v. *Northwest Steel Mills,* 311 U.S. 46, 49), and with the consistent and long-standing position of the Internal Revenue Service. See G.C.M. 22656, 1941–1 Cum. Bull. 293; Rev. Rul. 60–139, 1960–1 Cum. Bull. 677.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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offices, only the Hancock Bank, of Hancock, Maryland, is at present making payments to old depositors under waiver and lien agreements. There are 4,799 insured national banks, whose books are examined by the Comptroller of the Currency, and the Examination Division of the Comptroller's Office has advised us that they know of no national banks at present making payments, or under an obligation to make payments, under waiver and lien agreements. Finally, there are 1,350 insured State banks which are members of the Federal Reserve, and whose books are examined by the Federal Reserve Board. The Division of Examinations of the F.R.B. has advised us that they know of no bank in any of their 12 regions that is paying or is under an obligation to pay old depositors under waiver and lien agreements.

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